To the Management of the
  Town of Harpswell, Maine:

In planning and performing our audit of the financial statements of the Town of Harpswell (the Town) for the year ended December 31, 2005, we considered the Town's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The attached schedule summarizes our comments and suggestions concerning those matters. This letter does not affect our report dated January 20, 2006, on the basic financial statements of the Town.

The accompanying comments and recommendations are intended solely for the information and use of management and others within the organization and should not be used by anyone other than these specified parties.

We wish to express our appreciation for the cooperation and assistance we received from the officials and employees of the Town of Harpswell during the course of our audit. We will review the status of these comments during our next audit engagement. We have already discussed them with various Town personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Sincerely,

Runyon Kersteen Ouellette

On-line receipting system: The on-line receipting system currently being used by the Town allows for the entering of a collection as either a "cash" transaction or a "check" transaction. We noted that this feature was not always being used. As a result, at the time of cash up, it was not known exactly how much cash should be expected versus how much of the receipts were represented by checks. Using this feature can both simplify the cash up process as well as ensure a proper audit trail is maintained of the actual transaction.

Additionally, it was noted that although the "cash" versus "check" feature was part of the software, the actual reports that were used to prepare the deposit did not provide a total of the cash versus checks. This results in unnecessary manual work. We would recommend the Town contact the software vendor and determine what modifications need to be made so that these totals will print on the reports.

Transaction responsibility: One feature that strengthens internal controls is the ability to assign responsibility for a given transaction to a particular employee. The system provides for this by requiring the employee to enter their initials when processing the transaction. As a result, reports can be run when the deposit is being prepared *by employee*, to ensure that individually, as well as collectively, the work proves to the funds in the cash drawers. Our only concern in this area is that is does not appear that the system has a control that would prevent one employee from entering the initials of another employee when typing in a transaction. Although passwords are required to access the software initially, there is no password control at the step of entering the initials.

Use of individual cash drawers: It is imperative to proper internal controls that each employee be assigned their own cash drawer, with their own set amount of change. The drawers should have locking covers so when they are removed by the employee to store in the safe at night they can be kept intact. The actual counter drawers should also have locking features so that if the employee needs to step away from the work area, the drawer can be locked by that particular employee. This control would further ensure that each employee is responsible for their own cash. Shortages can be appropriately addressed with the proper employee. This feature also serves to protect those not responsible for shortages which are a result of the work of others.

Cash up procedures in the Tax Collector's office: In all cases, when preparing the cash receipts for deposit, it is best practice to always deposit all cash receipts from the given day in the evening before closing the office. The cash and checks should be counted by the individual employees and reconciled to their work outlined in reports printed from the cash receipting software. The reports should be run by employee, and each individual employee should cash up their own individual drawers. All cash and checks received for that day should be included in the deposit, with only the original funds being left in the drawer. Any cash overages or shortages for the day should be noted on the cash up sheet for proper posting by the bookkeeper. Also, if mistakes are noted with particular transactions, i.e. a customer paid too much or too little, it should be addressed immediately by either voiding the transaction and returning the funds to the customer (generally in the case of a short), or by including the entire amount in the deposit but alerting the bookkeeper that a refund is due a particular customer (generally in the case of an overpayment). In no case should the difference be set aside for a future day.

Interest charged on delinquent taxes in the Tax Collector's office: We noted a number of instances in which judgment was used in determining how much interest should be charged on a delinquent tax. For example, if a check came by mail, and the amount was not for the exact amount of the interest, the amount might be adjusted to the amount that would have been due based on the postmark date, or earlier. We noted a number of instances in which we are unsure how the amount of interest was actually calculated. Although individual amounts appear to be small, we feel it is important to have a set written policy with respect to how and when interest charges can be waived. The policy should spell out what is up to the discretion of the collector, and what would need Selectmen approval. Periodically, perhaps at least twice a year, we recommend that the Treasurer review interest charges to ensure that the policy is being followed as intended.

Under paid tax amounts in the Tax Collector's office : In addition to a policy with respect to interest charges for property taxes, we recommend the Town establish a policy to write off certain very small amounts at least once a year. This would not be intended for amount to be abated, but rather would cover situations in which small underpayments exist in the accounting records that are not worth the Town pursuing.

Cash receipts: When observing cash collections at the Town Clerk's counter, it was noted that a separate manual receipt record was maintained for every transaction for the day. Although this system did seem redundant, we understand it provides useful information for the Clerk's office regarding the transaction types and amounts. However, this manual system should not replace the important step of entering the transaction into the computer when the transaction is taking place.   We noted several instances when the transaction was set aside and entered into the computer system at a later time, once the customer had left. Control over the cash receipt is established when it is entered into the computer system. We would recommend the practice of waiting and entering receipts later be avoided.

Segregation of duties and system access: The Town's current software package allows for password use in entering certain accounting modules within the system. In establishing and maintaining proper segregation of duties, it is imperative that certain individuals don't perform certain incompatible functions.   In addition to assigning functions properly, controls should be set in the software itself such that certain individual cannot even access certain functional areas.   We would suggest that cash receipting stations are prohibited from anything but a read only access to any general ledger functions other then the treasurer and tax receipting modules. In addition, no one other than the bookkeeper should have access to the general ledger system to actually prepare and post general journal entries.   In addition, the current Treasurer performs many oversight responsibilities that provide controls not often seen in a smaller Town environment.   In order to have the Treasurer continue to serve this important function, we would recommend that she not be given access to any software except in a read only capability.   This way, the role is truly oversight, and would not lapse into a situation in which she is reviewing her own work.

Bookkeeping/journal entries: The process of making journal entries to correct errors or to post unusual transactions is a common bookkeeping function. Based on our review, it appears the use of journal entries is appropriate. However, because journal entries can be a way in which management can override their own internal control systems, it is imperative that journal entries be reviewed and approved by someone other then the preparer. Additionally, adequate documentation should be maintained in the journal entry book or file so that when reviewing history, a proper audit trial is provided. We would recommend that the journal edit be printed and initialed by the Treasurer or Administrator prior to posting, and that any relevant backup be maintained in the file.

Bringing actual deposit to banking institution: If proper cash up procedures are performed such that the deposits are being made intact daily after being properly reconciled to transaction reports, the act of bringing the deposit from the Town Office to the banking institution does not necessarily need to be performed by the individuals responsible for the various collection offices. In fact, once the deposits are prepared and placed in a locked bag, any responsible party can perform the "courier" function.   Some organizations even utilize an outside courier service to perform the task.   The current practice of both office representatives traveling to the bank independently seems redundant.   We would recommend that at a minimum the task is shared on a rotational basis.

Policy manual: It was noted that the Town has a number of good policies, all of which are maintained in a policy notebook. We did note however the absences of at least one important policy which we feel the Town should consider adopting – an investment policy. In reviewing current deposit and investment practices, we have no immediate concerns, however a written policy will provide guidance to future administrations and provide for controls and limits on such things as credit risk tolerance, concentration limitations, and interest rate risk (maturities).

Additionally, we would recommend that the policy book be consistently maintained by providing the dates the policies were adopted or amended on every policy page. It also should note whether the policy was adopted at the Town meeting level, the Selectmen's level, or simply adopted as best practices by the Town's administration.

Recycling Center petty cash: Petty cash at the Recycling Center does not appear to be physically controlled. We would suggest that it be maintained in a locked box in a locked cabinet or drawer. This is especially important because the office is not consistently occupied, and the attendant often has to leave the office unattended for periods of time. As with any petty cash system, responsibility should be assigned to one individual and only that individual should maintain keys for access.

Also, with respect to universal waste receipts, we understand that although the cash it brought to the Town Office nightly, it is not "cashed up" and deposited on a regular basis. We did n ote that the amounts are often small on a daily basis, but would recommend that a consistent practice be establish by means of a written policy. For example, a policy might be adopted that calls for receipts to be cashed up weekly, every Wednesday, unless they exceeded a certain threshold in which case a cash up would be required on the day that the funds on hand exceed the established limit. In any case, cash should be counted daily before funds are brought to the Town Office, and a record of balances should be maintained.

Transfer Station: The Transfer Station currently allows employees and others to remove items for re-use that other individuals have left behind. We do understand the value of this type of "recycling" such that items are eliminated from the trash stream. However, there is no apparent tracking of this practice. We feel the Town should adopt a policy with respect to what is allowed in this area and what practices would be discouraged. Additionally, a log should be maintained to track items that are removed by employees or others. This log should be periodically reviewed by the Selectmen to ensure they are comfortable that this practice is consistent with the adopted policy.

Petty cash policy: It appears the current petty cash policy maintained in the policy book is in need of updating. Amounts, locations and custodians should be spelled out in the policy and updated as necessary over time.

General ledger: The current practice is that the Town maintains one fund in its general ledger to account for all activity of the Town. Although this may be adequate, it is often useful for a Town to adopt a fund accounting system which is consistent with the reporting required in the annual financial statements. Funds with special restrictions, such as special revenue funds or capital projects, can be tracked separately from other general operating revenues and expenditures, in a separate self balancing group of accounts. This type of system can assist management in a variety of ways, one being that the Town would have the ability to quickly ascertain fund balance position in the general operating fund without having the restricted revenues and expenditures distorting the overall general fund picture.

Also, with respect to the Town's cu rrent chart of accounts, we noted a number of accounts no longer being used. These accounts should be eliminated to avoid unintended postings. Also, when establishing new accounts, account numbers should be assigned in an order that is consistent with proper accounting – that being assets, liabilities, and fund balance accounts – in their order of liquidity.

Finally, with respect to accounting for grant funds, in no case should grant revenues be "netted" against grant expenditure in the same account. All revenues should be posted to proper revenue accounts and all expenditures to proper expenditure accounts. The current accounting system set up (i.e. no separate funds) would require the tracking of net grant balances on separate manual spreadsheets, which we understand is currently the practice.

Bank reconciliations: We understand the practice of monthly bank reconciliations has become a priority for the Town and we commend the practice of performing this task within days of receiving the information from the banking institution. We would recommend that if any differences arise from this reconciliation process, that journal entries be posted promptly to correct the amounts such that they do not repeat on subsequent bank reconciliations.

General accounting training and oversight: The Town currently has a number of significant positions that perform a number of critical accounting functions for the Town. This would include the Tax Collector, Town Clerk, Treasurer and Bookkeeper. These positions require a great deal of skill and training in order for individuals to become fully proficient. As is the risk with any position, turnover can result in problems if others within the organization are not familiar with the procedures, tasks and practices. The Town might consider whether they could benefit from a full or part time finance professional to provide oversight and guidance in all of these areas, as well as to provide support to the Town Administrator and the Selectmen. It should be noted that currently the Town enjoys the benefit of the Treasurer performing a number of these functions.